

State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
OPERATIONS COMMITTEE MEETING

Location:

Alaska State Museum, Lecture Hall
395 Whittier Street
Juneau, Alaska

September 18, 2019

ATTENDANCE

Committee Present:

Tom Brice, *chair*
Commissioner Kelly Tshibaka (arrived 3:20 p.m.)
Robert Johnson
Gayle Harbo
Norm West
Bob Williams
Lorne Bretz

Other Trustees Present:

Commissioner Bruce Tangeman
Allen Hippler

Department of Revenue Staff Present:

Bob Mitchell (chief investment officer)
Pamela Leary (director, Treasury Division)
Shane Carson (manager of external equity & defined contribution investments)
Mark Moon (manager of internal equity)
Stephanie Alexander (board liaison)

Department of Administration Staff Present:

Ajay Desai (director, Division of Retirement & Benefits)

Others Present:

Stuart Goering (assistant attorney general, Department of Law)
Jack Ferdon (ISS Governance)

I. CALL TO ORDER

CHAIR TOM BRICE called the meeting to order at 2:37 p.m.

II. ROLL CALL

Six committee members were present at roll call to form a quorum.

III. PUBLIC MEETING NOTICE

Board liaison STEPHANIE ALEXANDER confirmed public meeting notice had been met.

IV. A. Approval of the Operations Committee Agenda

MR. WEST moved to approve the agenda. MS. HARBO seconded the motion.

The motion to approve the agenda passed without objection.

B. Approval of the Operations Committee Minutes - June 19, 2019

MS. HARBO moved to approve the Operations Committee Minutes of the June 19, 2019 meeting. MR. WILLIAMS seconded the motion.

The motion passed without objection.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES

None

VI. POLICIES AND PROCEDURES RECOMMENDATIONS

A. Proxy Voting: Current Policies

CHAIR BRICE introduced SHANE CARSON, Manager of External Equity & Defined Contribution Investments Department of Revenue (DOR), to present on proxy voting. MR. CARSON introduced MARK MOON, Manager of Internal Equity DOR, and JACK FERDON from ISS Governance. MR. CARSON explained a proxy vote is a vote cast by one person as a representative of another. This is relevant to the plans when investment managers and internal staff vote proxy shareholder ballots for different initiatives before the corporate meetings. The votes can help drive or impact the long-term shareholder value at the companies and may include issues such as:

- Merger or acquisition decisions
- Retention and termination of directors
- Shareholder initiatives

MR. CARSON discussed the current ARM Board guidelines for proxy voting. Staff reviews external managers' proxy voting policies before adoption and execution of the contract. The ARMB Compliance team conducts an annual review that includes examination of:

- ARMB guidelines
- External manager policies
- External manager prior year voting records
- External manager statement meeting proxy voting fiduciary obligations

The Compliance team reports annually to the Audit Committee.

MR. WEST inquired as to the frequency the vote deviates with management. MR. CARSON noted the external managers have not been polled with that question and he does not know the answer. He will poll the external managers if the ARMB wishes. MR. FERDON commented the managers rarely vote against management on director elections. The ARMB plans voted against management on 6% of all director elections. The ARMB plans did not vote against any merger or acquisition transactions. The ARMB plans voted against management on approximately 11% of executive compensation practices.

MR. WEST requested additional information on the fiduciary process to ensure the proxy votes are in the best interest of the plans. MR. CARSON explained the external managers each have specific policies that dictate their processes and guidelines. The external managers provide their certifications affirming they have met their fiduciary obligation. MR. MOON discussed the Internal Equity Management group maintains approximately 2,300 individual equity security positions. Last year, ISS was utilized as a partner to provide vote recommendations and to cast about 40,000 proxy votes on behalf of the Internal Equity Management group. MR. MOON believes ISS maintains a global leading expertise in crafting guidelines for voting proxies that are likely to maximize shareholder value. The Internal Equity Management group reviews the ISS proxy voting policy on an annual basis and submits disclosures to the Compliance department similar to the outside manager requirements.

MR. FERDON continued the presentation discussing ISS' benchmark voting policy. The two main goals of the policy are long-term shareholder value creation and risk mitigation. This is achieved by voting to promote shareholder rights and by improving company disclosure. MR. FERDON gave a detailed description and anecdotal examples of the four pillars of the corporate governance philosophies driving the ISS benchmark voting policy;

- Accountability
- Stewardship
- Independence
- Transparency

MR. WILLIAMS asked if MR. FERDON can provide examples of voting against management due to social or environmental reasons. MR. FERDON explained those discrepancies would be covered in the benchmark policy when a shareholder proponent includes the issue on a ballot regarding a company's role in an environmental impact or a request for employee diversity statistics. ISS does not support issues that would force the Board to take an action. ISS may support a proposal seeking better disclosure of the issue, if ISS believes the issue is important and the company is not already disclosing adequately. MR. FERDON noted he does not recall an instance of voting against a director based on an environmental issue.

MR. FERDON described the process by which the ISS policy evolves and is amended. Input is inclusive and consideration is given to analysts from ISS, the investor community, and the corporate community. Communication is transparent and survey results are published. An open comment period is held, which searches for unintended consequences to policy updates.

MS. HARBO commented on the ISS fee of approximately \$51,000 per year. She requested additional information regarding the fee structure. MR. FERDON explained the typical pricing structure is based on a per ballot fee and a per research fee for every discreet voting meeting.

MR. CARSON informed three of the nine active external managers have adopted the ISS guideline policy outright. Every non-US active manager has employed ISS in some fashion, whether it is employing their research, the adoption of policy, the voting process, or all three.

B. ARMB Policies and Procedures Red-Line for Discussions

CHAIR BRICE introduced BOB MITCHELL, Chief Investment Officer, to present the discussion on the red-line version of the ARMB Policy and Procedures Manual. The intent is for the action to be brought before the full ARM Board for consideration at the December meeting. This review is to provide the Committee an opportunity to opine on the red-line version of the manual. The changes were prompted primarily by a study conducted by Callan regarding the ARM Board's investment policies. Within the red-line edits are responses to all of the Callan recommendations. Additionally, the actual text from the Callan report is provided in the margin of the red-line document. Other changes include updated language or further clarifications.

CHAIR BRICE requested discussion on any changes seeking more authority for the Department or staff, or where there are increased expectations for Trustee engagement. MR. MITCHELL believes the most significant recommendation from the Callan study was to edit the language relating to the mission statement regarding the definition of best run and managed pension fund. The wording of "top quartile returns" would be replaced with "superior returns". The returns are also being related to the strategic asset allocation of the fund, as opposed to solely reviewing performance relative to peers. MR. MITCHELL characterized the majority of the changes as clarifications of existing practices.

MR. WILLIAMS requested clarification of the discrepancy between the printed Callan comments on page 15 and the red-line change on page 15 regarding the wording of "top quartile". MR. MITCHELL advised the printed Callan comments are inaccurate and should not include the wording of "top quartile".

MR. JOHNSON commented there is no reference to proxy voting in the Policy and Procedures Manual. Proxy voting is included in the investment guidelines. MR. JOHNSON inquired if there is a structural merit to the inclusion of some of the broader resolutions within the Policy and Procedures Manual to create a useable, single volume resource for Trustees. MR. MITCHELL believes the Policy and Procedures Manual is the primary reference and is supplemented by the number of specific resolutions the Board has enacted. The Board could choose to compile all information into one document and revise the document with each change.

MR. WILLIAMS discussed the change to red-line the "ARMB Chair" from page 12 under Liaison to Officer to ARMB. He is supportive of the ARMB Chair's engagement in the processes. MR. JOHNSON agreed, and noted he has provided comments to MR. MITCHELL regarding this area to include wording such as, "in coordination with the ARMB Chair," as opposed to striking the ARMB Chair. The liaison role will be maintained, while considering the structure at Department of Revenue. MR. WILLIAMS concurred with MR. JOHNSON's wording addition. CHAIR BRICE suggested the possible option of using the word consultation instead of coordination. MR. MITCHELL expressed appreciation for the input.

CHAIR BRICE informed this agenda item will be considered again at the December meeting.

VII. BUDGET CONSIDERATION

- 1. Review FY2019 Final Budget**
- 2. Review FY2020 as Approved by the Legislature**
- 3. Review Proposed FY2021**

CHAIR BRICE introduced PAMELA LEARY, Director, Treasury Division, to present on the budget considerations. MS. LEARY gave an overview of the budget development process. Prior year costs are reviewed and adjusted for any known new costs or known budget constraints. The total actual costs from every department are finalized August 30th, which makes for a tight turnaround to prepare the next year's budget. The ARMB budget has two components; the operations component and management fees/custody costs component.

MS. LEARY explained costs of the Treasury are shared by the ARM Board funds and State funds. Costs are divided into preapproved categories. The Treasury utilizes a cost allocation plan that splits costs pro rata based on assets under management. Each year, the Treasury prepares the budget with the intent the Committee will recommend the budget to the full Board for adoption, subject to appropriation by Office of Management and Budget (OMB) and the Legislature.

MS. LEARY reviewed the FY20 authorized budget amounts compared to the FY21 proposed budget amounts. The budget maintains a small amount of excess capacity that can be used for needs yet to be identified or yet to be purchased, such as a risk analytics software component. A survey of staff is conducted annually to determine the level of allocation of compensation to the ARMB budget. MS. LEARY informed ARMB assets represent approximately 80% of the assets managed by Treasury.

MS. LEARY discussed a question asked in a previous meeting by COMMISSIONER TSHIBAKA regarding the reasons for the variation in budgeted amounts for the non-employee travel line item from years FY16 through FY20. MS. LEARY researched and it was determined the variations were a function of who was coding the underlying information and some of the non-employee travel was erroneously coded as employee travel. The general budget trend line was increasing until FY19. The travel budget for FY20 and FY21 has diminished significantly.

MR. JOHNSON requested clarification regarding the line items of Personal Services Board of \$75,000, Non-Employee Travel of \$22,000, and Board Meeting Expenses of \$75,000. MS. LEARY explained Personal Services Board is the honorarium cost. The Non-Employee Travel is the cost for Board member travel, not including the Commissioners. She explained the total travel budget for both employee and non-employee is \$50,000. MS. LEARY noted she could provide the specific breakdown of the travel budget, which is approximately \$6,500 per ARM Board meeting. The Board Meeting Expenses include the room facility rental, stenographer and transcription services, audio/visual services and equipment, food, and office supplies. MS. LEARY noted she will provide a specific breakdown of the Board meeting costs.

MR. JOHNSON commented that it seems sadly inefficient reallocations cannot be made within those three Board expense areas. He finds it to be a distressingly strict perspective.

COMMISSIONER TANGEMAN commented on the overall budget. He attended the initial budget meeting with OMB yesterday and noted OMB is very pleased with the work of MR. MITCHELL and the Board regarding the shift from active equity management to passive equity management and the increase of internally managed funds. These strategies are saving the plan \$10 million in fees.

COMMISSIONER TANGEMAN discussed the overall State budget is expected to be cut by over \$600 million. He believes it is necessary for the ARM Board to prioritize budget items, such as building a Treasury compensation plan to retain the asset management talent and allowing staff to travel to conduct necessary due diligence. COMMISSIONER TANGEMAN informed OMB at yesterday's meeting of the proposed \$130,000 compensation incremental step plan for Treasury employees. He discussed a hypothetical scenario whereby OMB agreed to the compensation step plan, as long as the funds are covered internally. Other priorities will have to be considered, such as meeting face-to-face or conducting teleconference Board meetings.

MS. LEARY explained the travel line item is one of four budget line items seen publically and is highly scrutinized. It is necessary to ensure the team can conduct the needed due diligence within the travel constraints, which is why all the regularly scheduled Board meetings are in Juneau and one meeting was suggested to be conducted via video conference.

CHAIR BRICE commented the FY20 employee travel of \$27,500 is an aggressive cut from the FY19 employee travel of \$165,000. He inquired if the budget constraints allow staff to conduct the necessary due diligence. COMMISSIONER TANGEMAN believes conducting due diligence is both a budget priority and a budget challenge. The budgeting struggle is becoming increasingly prominent.

COMMISSIONER TSHIBAKA discussed her travel and COMMISSIONER TANGEMAN's travel to the ARM Board meetings are not included in the ARMB's budget employee travel line item, but is taken from their respective budgets. She noted out of her six to seven allowable trips a year, three to four of them are consumed with ARM Board meetings.

COMMISSIONER TSHIBAKA inquired as to the reason for the substantial increase in IT support from FY19 to FY20. MS. LEARY discussed the explanation contains multiple intertwined categories, including DOR ASD Support Services, which doubled from about \$200,00 in FY18 to \$500,000 in FY19, and telecommunications. Some of the coding costs shifted among the categories. COMMISSIONER TSHIBAKA recommended MS. LEARY consult with OIT to consolidate servers or telecom use to decrease the total spend. COMMISSIONER TSHIBAKA stated she is willing to set up the meeting with the appropriate person at OIT.

COMMISSIONER TSHIBAKA requested additional information regarding the doubling of the request for the legal line item. MS. LEARY explained the increased legal line item has

been in process for three years. An old MOU exists with the Department of Law that is being updated and much of the securities litigation work is being transferred. An RSA has been signed this year and the costs of a dedicated lawyer will be shared. STUART GOERING, Assistant Attorney General, Department of Law, advised the amount of securities litigation has increased in order of magnitude over the last 10 years for both the ARMB and the Permanent Fund. The dedicated attorney will be able to focus on areas such as securities fraud, antitrust issues, and foreign jurisdictions. The expectation is active litigation will result in additional recovery of the losses that have occurred in the funds.

COMMISSIONER TSHIBAKA submitted for consideration the suggestion to reduce the Subscriptions and Training line item from \$48,000 to \$35,000. CHAIR BRICE reviewed the FY19 actuals for the individual Subscription and Training line items. MS. LEARY explained she has made a contribution to decreasing the membership expenses this year by reducing her membership to the National Association of State Treasurers (NAST), which is not included in the ARMB budget. Many of the books, education and training relate to CFA or CPA trainings. She is willing to target a lower budgeted amount, while maintaining the authorization for trainings and exams.

MR. JOHNSON asked if OMB has ever considered the option of a budget based on a delineated basis-point amount of the total assets. For example, the budget amount would be no more than 50 basis points of total assets, and the line item allocations could be decided internally. COMMISSIONER TANGEMAN believes MR. MITCHELL may have additional information regarding the intent to reduce the expenses to the lowest per basis-point amount possible. COMMISSIONER TANGEMAN feels OMB has given fair treatment to ARMB and DOR during this most recent budget cycle. He thinks the ARMB has done quite well in reducing the asset management fees.

MS. LEARY indicated the Permanent Fund has unsuccessfully attempted to approach their budget on a similar basis-point configuration. She does not have information regarding their budget approach this year. MR. MITCHELL acknowledged the process of managing expenses as a function of the market value of the assets can be considered. Discussions have occurred within the Permanent Fund, and additional discussions with OMB may unfold as the budget processes move forward this fall, but no formal action has been taken to continue in that direction.

MR. WILLIAMS requested further explanation regarding the cause of the wide range of management fees. MR. MITCHELL explained there are fixed costs that have to be maintained for all levels of assets. For underlying investments that are relatively small, the expenses will be relatively higher. He noted new or young private equity investments have costs that are based on the committed capital and not the actual capital. This is referred to as the "J" curve for private equity. MR. WILLIAMS asked if there are more opportunities available to continue trimming the overall fees. MR. MITCHELL agreed. He advised almost 90% of the expenses are investment management fees and 10% are Treasury expenses. A proposal will be recommended to the Board tomorrow evaluating the international equity manager structure. The recommendations, if approved, would result in further reduction of

management fees. MR. MITCHELL highlighted the importance of maximizing net-of-fee outcomes.

MR. WEST understands budget funds are authorized by the Legislature. He requested clarification as to which of the ARM Board budget items are paid for by the State's general funds and which items are paid for by the earnings of the Trust funds. MS. LEARY advised all expenses in the budget are being paid for from the earnings of the Trust. There are no general fund allocations in the ARM Board budget. It was further explained that even though the source of the funds is the Trust, the Legislature has to appropriate the funds and the Governor has the opportunity to veto. CHAIR BRICE commented the Administration is purposefully not differentiating between State general funds and funds from program receipts for creating the budget.

Action: FY2021 ARMB Budget Proposal

MR. JOHNSON moved to table the action regarding the FY2021 ARMB Budget Proposal.
MS. HARBO seconded the motion to table.

A roll call was taken, and the motion to table the action passed, with MR. WILLIAMS and CHAIR BRICE voting against, and COMMISSIONER TSHIBAKA not present.

MS. LEARY inquired as to the next steps in the process now that the action is tabled and what information will the Committee report to the full ARM Board. CHAIR BRICE informed his report will include the motion was to table and no action was taken. The ARM Board has the discretion to remove the action off the table.

VIII. SCOPING FOR FUTURE MEETINGS

A. Calendar Discussion

The 2019-2020 calendar is included in the packet.

B. Potential Topics

None

IX. OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

None

X. PUBLIC / MEMBER COMMENTS

None

XI. ADJOURNMENT

MS. HARBO moved to adjourn the meeting. MR. WILLIAMS seconded the motion. The motion passed without objection.

The meeting was adjourned at 4:26 p.m.

Note: An outside contractor recorded the meeting and prepared the summary minutes. For in-depth discussion and presentation details, please refer to the recording, staff reports, and written presentation materials on file at the ARMB office.